



COMMONWEALTH OF MASSACHUSETTS
OFFICE OF CONSUMER AFFAIRS AND BUSINESS REGULATION
DIVISION OF INSURANCE

REPORT OF EXAMINATION OF
HEALTH NEW ENGLAND, INC.

Springfield, Massachusetts

As of December 31, 2015

NAIC GROUP CODE 04756

NAIC COMPANY CODE 95673

EMPLOYER ID NUMBER 04-2864973

HEALTH NEW ENGLAND, INC.

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COMMONWEALTH OF MASSACHUSETTS
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DIVISION OF INSURANCE

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GARY D. ANDERSON
ACTING COMMISSIONER OF INSURANCE

May 31, 2017

The Honorable Gary D. Anderson
Acting Commissioner of Insurance
Commonwealth of Massachusetts
Division of Insurance
1000 Washington Street, Suite 810
Boston, MA 02118-6200

Honorable Commissioner:

Pursuant to your instructions and in accordance with Massachusetts General Laws, Chapter 176G, Section 10, an examination has been made of the financial condition and affairs of

HEALTH NEW ENGLAND, INC.

at its home office located at One Monarch Place, Springfield, MA 01144. The following report thereon is respectfully submitted.

SCOPE OF EXAMINATION

Health New England, Inc. ("Company" or "HNE") was last examined as of December 31, 2012 by the Massachusetts Division of Insurance ("Division"). The current examination was conducted by the Division and covers the three-year period from January 1, 2013 through December 31, 2015, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination.

The current examination was conducted in accordance with standards and procedures established by the National Association of Insurance Commissioners ("NAIC") Financial Condition (E) Committee and prescribed by the current NAIC *Financial Condition Examiners Handbook*, the examination standards of the Division and with Massachusetts General Laws. The Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company, including corporate governance, identifying and assessing inherent risks within the Company, and evaluating system controls and procedures used to mitigate those risks.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management's compliance with Statutory Accounting Principles. The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination an adjustment is identified, the impact of such adjustment will be documented separately following the Company's financial statements.

This examination report includes significant findings of fact, as mentioned in the Massachusetts General Laws, Chapter 176G, Section 10 and general information about the insurer and its financial condition. There may be other items identified during the examination that, due to their nature (e.g. subjective conclusions, proprietary information, etc.), are not included within the examination report but separately communicated to other regulators and/or the Company.

The Company is audited annually by Deloitte & Touche LLP ("Deloitte"), an independent certified public accounting firm. The firm expressed unqualified opinions on the Company's financial statements for the calendar years 2013 through 2015. A review and use of the Certified Public Accountants' work papers was made to the extent deemed appropriate and effective. The Company is required to comply with the Model Audit Rule ("MAR"). All control work papers associated with MAR compliance have been reviewed as a source of information and were tested and leveraged as deemed appropriate and effective.

Baker Tilly Virchow Krause, LLP ("Baker Tilly") was engaged to perform certain agreed upon procedures, which are in compliance with the NAIC *Financial Condition Examiners' Handbook*. The assistance included a review of accounting records, information systems and investments. Lewis & Ellis, Inc. were contracted by Baker Tilly to perform a review of the actuarially determined loss and loss adjustment expense reserves, as well as other significant actuarial estimates.

SUMMARY OF SIGNIFICANT FINDINGS OF FACT

Please refer to the “Comments on Financial Statement Items” and Summary of Recommendations” sections at the conclusion of the Report.

COMPANY HISTORY

The Company was originally formed as a for-profit Health Maintenance Organization (“HMO”) domiciled in the State of Massachusetts. The Company was incorporated on May 17, 1985 and received a license from the Massachusetts Commissioner of Insurance on November 27, 1985 and commenced business on January 1, 1986. The United States Department of Health and Human Services declared HNE an HMO on June 1, 1987.

The Company was formed by capital contributions from three hospitals, including Baystate Health, Inc. (“Baystate”) and a group of Baystate affiliated private physicians. Since its formation, HNE has undergone a reorganization, the results of which are Baystate now owning 100% of the Company.

On January 1, 2013, the Company reorganized and converted to a not-for-profit corporation. The Department of the Treasury granted this conversion on November 30, 2015, effective the date of the reorganization.

MANAGEMENT AND CONTROL

Board of Directors

According to the bylaws, the Board of Directors (“Board”) shall consist of up to sixteen (16) directors, consisting of two directors serving *ex officio* and up to fourteen (14) directors elected by the Corporate Member at the annual meeting of the Corporate Member or at a special meeting called for that purpose. The directors serving *ex officio* shall be the Chief Executive Officer of Baystate Health Inc., or an individual designated by him or her in writing to serve as acting Chair for one or more meetings of the Board, and the President and Chief Executive Officer of the Corporation. As of December 31, 2015, the Company's Board of Directors consisted of the following individuals:

<u>Director</u>	<u>Title</u>
Mark A. Keroack, MD, MPH, (Chair) <i>ex officio</i>	President & Chief Executive Officer, Baystate Health Inc.
Carol Campbell	President & Founder, Chicopee Industrial Contractors, Inc.
Dennis Chalke	Sr. Vice President Finance, Chief Financial Officer and Treasurer, Baystate Health Inc.

Health New England, Inc.

Joel Feinman, PhD	President, Valley Medical Group, Greenfield Health Center
Frederick W. Fuller, III	President, Retired, Holyoke Card & Paper
Benjamin Liptzin, MD	Chairman, Department of Psychiatry / BMERF, Baystate Health, Inc.
Maura C. McCaffrey, <i>ex officio</i>	President & Chief Executive Officer, Health New England, Inc.
Anne M. Paradis	Chief Executive Officer, MicroTek
Richard Segool, MD (Vice Chair)	Pediatrician, Pioneer Valley Pediatrics
Mark R. Tolosky, Esq.	President & Chief Executive Officer, Retired, Baystate Health Inc.
Howard Trietsch, MD	Managing Partner, Baystate Ob/Gyn Group, Inc.

Committee of the Board of Directors

The Company's bylaws allow that the Board of Directors may appoint such committees of the Board as are deemed necessary. Board committees shall act under the supervision of the Board and shall act with respect to such special or general matters as the Board may from time to time determine. Standing committees of the Board include an Executive Committee and Governance Committee which shall carry out the functions of a Nominating Committee. The Baystate Health Inc. Audit & Compliance Committee, serving in the same capacity for HNE, is responsible for the oversight of the audit function and approval of external audit firms, scope, and results. Other committees include a Finance Committee, Compensation Committee and the HNE Quality Management Committee.

Officers

According to the Company's bylaws, the officers shall consist of a Chair of the Board, President/Chief Executive Officer, a Treasurer, a Secretary and such other officers with such other titles as the Board of Directors may determine from time to time, including, but not limited to, a Vice Chair of the Board, one or more Vice Presidents, Assistant Treasurers and Assistant Secretaries and such other officers as may be appointed pursuant to these bylaws.

Officers of the Company as of December 31, 2015 were as follows:

<u>Officers</u>	<u>Title</u>
Maura C. McCaffrey	President & Chief Executive Officer
Judith M. Danek	Secretary
Dennis Chalke	Treasurer
Kenneth Bernard	Vice President, IT
Laurie Gianturco, MD	Vice President, Senior Medical Director
Jody Gross	Vice President of Sales
James Kessler, Esq.	Vice President & General Counsel
David Methe	Security Officer
Jason Rio	Director of Compliance
Amy Trombley	Vice President & Chief Talent Officer

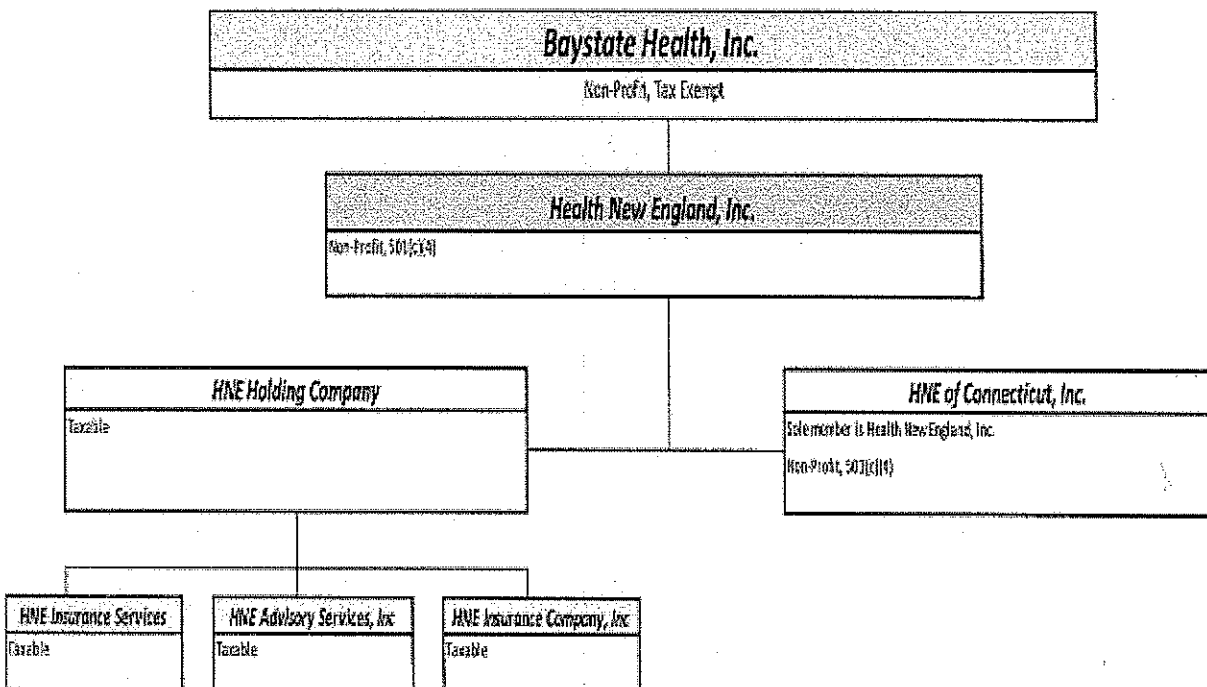
Health New England, Inc.

Holding Company

As stated in the Insurance Holding Company System Form B and Form C as filed with the Division, the Company is a member of a holding company system and is subject to the registration requirements of Massachusetts General Law, Chapter 176G, Section 28 and Regulation 211 CMR 7.00. Baystate Health, Inc. is the “ultimate controlling person” of the Holding Company System.

Organizational Chart

The following documents the Company’s organizational chart as of December 31, 2015:



Transactions and Agreements with Subsidiaries and Affiliates

The following is a summary of each of the intercompany agreements between the entities within the holding company structure documented in the organizational chart above:

Capital Maintenance Agreement: Effective November 13, 2014, HNE entered an agreement with HNE of Connecticut in which HNE agrees to provide HNE of Connecticut with sufficient funds to maintain capital in accordance with Connecticut State Law and the requirements of the Connecticut Department of Insurance.

Provider Agreement: Under the terms of the provider services agreement with Baycare Health Partners, Inc., HNE pays a number of Baystate providers for services such as:

Health New England, Inc.

Inpatient Services, Outpatient Services, Physician Services, and other infrastructure and care management services. A provider fee schedule for the services provided is included in the agreement and updated on an annual basis. In addition, the fee schedule provides for shared savings through a risk-sharing arrangement.

Employer Group Agreement: This agreement, effective between HNE, HNE Advisory Services, and Baystate, provides for third party administrative services for Baystate's self-insured employee health insurance plans. Baystate pays the Company a per employee per month administrative fee for services provided.

Intercompany Services Agreement: Through this agreement between HNE, HNE Advisory Services, HNE of Connecticut, HNE Insurance Company, HNE Holding Company, and HNE Insurance Services, the Company provides administrative and other services between HNE and its subsidiaries.

In exchange for the services, HNE Advisory Services pays the Company 95% of its net (after broker commissions) administrative services revenue on a monthly basis as compensation for services. In addition, HNE Advisory Services pays a proportional share of HNE's total administrative costs on a monthly basis based on the proportion of HNE Advisory Services' member months to the sum of HNE and HNE Advisory Services member months.

HNE of Connecticut, HNE Insurance Services, and HNE Insurance Company pay a proportional share of HNE's total administrative costs on a monthly basis determined by assessing whether each entity used a particular expense and the proportion of each expense that is attributed to each entity.

Other Transactions: On January 1, 2014 HNE transferred and assigned to HNE Holding Company all the shares outstanding of HNE Insurance Company, Inc., HNE Advisory Services, Inc., HNE Insurance Services, Inc. and the recently dissolved Health New England of Connecticut (replaced by the formation of HNE of Connecticut, Inc.). This transition of shares was to organize all the for profit entities under one downstream holding company, HNE Holding Company.

In March and April of 2014, HNE contributed \$5.5 million to the newly formed entity HNE of Connecticut, Inc. HNE also received a \$5 million capital contribution in March of 2014 from its controlling entity, Baystate. Finally, on December 28, 2015, the Company received \$20 million in cash from Baystate in the form of a surplus note with a three year Treasury note rate.

TERRITORY AND PLAN OF OPERATION

The Company is licensed in Massachusetts and operates as an Independent Practice Association model HMO primarily in the five counties of Western Massachusetts including: Berkshire, Franklin, Hampden, Hampshire, and Worcester. The Company reported \$900,319,000 of 2015 direct premium written in Massachusetts during 2015.

The Company's primary lines of business consist of Comprehensive Group, Comprehensive Individual, Medicare, and Medicaid. The Company also conducts third-party administrative ("TPA") business through its downstream subsidiary, HNE Advisory Services, Inc. The Company has three other affiliated companies: HNE of Connecticut, Inc. is an HMO operating in Connecticut; HNE Insurance Company, Inc., provides Medicare Supplement Insurance in Massachusetts; and HNE Insurance Services, primarily places stop-loss coverage for Administrative Service Only groups administered by HNE Advisory Services, Inc.

REINSURANCE

Ceded Reinsurance

The Company is a party to an excess risk reinsurance agreement executed with RGA Reinsurance Company ("RGA"). This reinsurance agreement was in effect for each year under the examination period. For the agreement period January 1, 2015 through December 31, 2015, RGA agrees to pay covered losses incurred over the period, which are reported, paid and submitted by December 31, 2016. The agreement establishes a \$500,000 per member per period deductible with reinsurance coverage beginning once a \$750,000 aggregate Plan Deductible is met. Covered losses include: Inpatient Hospital Services, Inpatient Rehab Services, Skilled Nursing Facility Services, Outpatient Health Services, Home Health Care, and Drug Related Services. A reinsurance limit of \$5 million per member per period exists.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements prepared by management and filed by the Company with the Division and present the financial condition of the Company for the period ending December 31, 2015. The financial statements are the responsibility of Company management.

Statement of Assets, Liabilities, Capital and Surplus and Other Funds as of December 31, 2015

Statement of Revenue and Expenses for the Year Ended December 31, 2015

Reconciliation of Capital and Surplus for Each Year in the Three-Year Period Ended December 31, 2015

Health New England, Inc.

**Statement of Assets, Liabilities, Capital and Surplus
as of December 31, 2015**

	Per Annual Statement
Assets	
Bonds	\$ 90,123,069
Preferred stocks	68,000
Common stocks	23,603,142
Cash, cash equivalents and short-term investments	30,021,577
Other invested assets	5,615,476
Subtotals, cash and invested assets	149,431,264
Investment income due and accrued	495,115
Premiums and considerations:	
Uncollected premiums and agents' balances in the course of collection	12,811,663
Reinsurance:	
Amounts recoverable from reinsurers	1,225,018
Amounts receivable relating to uninsured plans	129,272
Electronic data processing equipment and software	604,452
Receivable from parent, subsidiaries and affiliates	1,916,711
Healthcare and other amounts receivable	6,835,166
Total Assets	<u>\$ 173,448,661</u>
Liabilities, Capital and Surplus	
Claims unpaid	\$ 81,834,134
Accrued medical incentive pool and bonus amounts	11,590,793
Unpaid claims adjustment expense	4,236,370
Aggregate health policy reserves	4,500,000
Premiums received in advance	17,631,800
General expenses due or accrued	10,947,685
Amounts due to parent, subsidiaries and affiliates	555,404
Aggregate write-ins for other liabilities	2,043,604
Total liabilities	133,339,790
Aggregate write-ins for special surplus funds	8,821,841
Surplus notes	20,000,000
Unassigned funds (surplus)	11,287,030
Total capital and surplus	40,108,871
Total liabilities, capital and surplus	<u>\$ 173,448,661</u>

Health New England, Inc.

**Statement of Revenue and Expenses
For the Year Ended December 31, 2015**

	As Reported by the Company
Member Months	<u>2,029,108</u>
Net premium income	<u>\$ 898,478,501</u>
Total revenues	<u>898,478,501</u>
Hospital and Medical:	
Hospital/medical benefits	569,208,560
Other professional services	6,412,610
Outside referrals	23,401,167
Emergency room and out-of-area	48,278,715
Prescription drugs	176,136,306
Aggregate write-ins for other hospital and medical	14,615,081
Incentive pool, withhold adjustments and bonus amounts	<u>11,393,367</u>
Subtotal	<u>849,445,806</u>
Less:	
Net reinsurance recoveries	<u>1,225,018</u>
Total hospital and medical	<u>848,220,788</u>
Claims adjustment expenses	25,283,940
General administrative expenses	<u>48,600,422</u>
Total underwriting deductions	<u>922,105,150</u>
Net underwriting gain (loss)	(23,626,649)
Net investment income earned	1,997,337
Net realized capital gains (losses)	<u>54,375</u>
Net investment gains (losses)	2,051,712
Net gain or (loss) from agents' or premium balances charged off	(18,250)
Aggregate write-ins for other income or expenses	1,125,000
Net income or (loss) after capital gains tax and before all other federal income taxes	(20,468,187)
Federal income taxes incurred	<u>0</u>
Net Income (loss)	<u><u>(\$20,468,187)</u></u>

Health New England, Inc.

Reconciliation of Capital and Surplus
For Each Year in the Three-Year Period Ended December 31, 2015

	2015	2014	2013
Capital and surplus prior reporting year	\$ 47,982,467	\$ 52,620,002	\$ 50,268,394
Net income or (loss)	(20,468,187)	(6,677,988)	2,267,235
Change in net unrealized capital gains (losses)	(1,068,780)	(1,681,914)	2,125,156
Change in net deferred income tax	0	0	(6,682,495)
Change in nonadmitted assets	(6,336,629)	(1,277,633)	5,124,062
Change in surplus notes	20,000,000	0	0
Capital Changes: Paid in	0	0	(482,350)
Aggregate write-ins for gains of (losses) in surplus	0	5,000,000	0
Net change in capital and surplus	<u>(7,873,596)</u>	<u>(4,637,535)</u>	<u>2,351,608</u>
Capital and surplus end of reporting year	<u>\$ 40,108,871</u>	<u>\$ 47,982,467</u>	<u>\$ 52,620,002</u>

**ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS RESULTING FROM THE
EXAMINATION**

There have been no changes made to the Financial Statements as a result of this examination.

COMMENTS ON FINANCIAL STATEMENT ITEMS

Claims Unpaid

The Company uses estimates for determining its claims incurred but not yet reported which are based on claim payment patterns, healthcare trends and membership and includes a provision for adverse changes in claim frequency and severity. Amounts incurred related to prior years may vary from previously eliminated liabilities as the claims are ultimately settled. The Company retained actuarial consultants to perform independent testing which showed that the Company's liabilities were within a range of reasonable estimates.

Lewis & Ellis actuaries prepared independent estimates of Unpaid Claim Liabilities ("UCL") for December 31, 2015 through a hindsight analysis as of August 31, 2016. For December 31, 2015, completion factors for the projection of ultimate claims were developed using historical payment patterns and actuarial judgment. "Low" and "High" estimates were developed by subtracting the claims paid-to-date from the actuarial range of incurred estimates. The actuarial estimates, as determined by Lewis & Ellis, indicate that the Company's UCL estimates were reasonable as of December 31, 2015.

Premium Deficiency Reserve

The Company did not hold a Premium Deficiency Reserve ("PDR") as of December 31, 2015. Based on a review of the best estimate projections at the time, Lewis & Ellis determined this was appropriate, and a PDR was not required for any of the Company's lines of business as of December 31, 2015. Lewis & Ellis did note however that the Company's method to calculate PDR did not follow strict statutory accounting principles. Statement of Statutory Principles No. 54 states in part that "for purposes of determining if a premium deficiency exists, contracts shall be grouped in a manner consistent with how policies are marketed, serviced and measured, and a liability shall be recognized for each grouping where a premium deficiency is indicated." The Company should develop any future PDR estimates in compliance with SSAP No. 54.

SUBSEQUENT EVENTS

ACA Assessment

On January 1, 2014, HNE was subject to an annual fee under Section 9010 of the Affordable Care Act ("ACA"). This annual fee is to be allocated to individual health insurers based on the ratio of the amount of the entity's net premiums written during the preceding calendar year to the amount of health insurance for any United States health risk that is written during the preceding calendar year. A health insurance entity's portion of the assessment becomes payable once the entity

provides health insurance for each calendar year beginning on or after January 1 of the year the fee is due. In 2015, HNE did write health insurance subject to the ACA assessment and paid the 2014 assessment amounting to \$5,379,385 in 2015. HNE was again subject to the annual fee in 2015 and paid the 2015 assessment amounting to \$7,706,634 in 2016. On January 1, 2017, the Company would have been subject to the annual fee however, the Consolidated Appropriations Act of 2016, Title II, section 201 suspended collection of the health insurance provider fee for the 2017 calendar year.

Identified Material Weakness and Significant Deficiency

In 2016, during the annual MAR controls assessment, the Company identified numerous deficiencies related to the preparation/approval of journal entries and maintaining proper supporting documentation. In 2017, during the annual audit of the Company's statutory financial statements, Deloitte, the Company's independent auditors requested the 2016 MAR findings. Based on the significance of the deficiency, Deloitte determined that the Company's internal controls over manual journal entries did not operate effectively and considered the deficiency to be a Material Weakness as of December 31, 2016. The control deviations encompass management's override of controls, lack of segregation of duties, and lack of documentation, and when considered in the aggregate were indicative of a material weakness in the operating effectiveness of the internal controls over recording of manual journal entries. In addition, Deloitte determined that the Company's internal controls over account balances including monthly reconciliations of all balance sheet accounts to be a Significant Deficiency, as there were noted instances where monthly account reconciliations were not prepared and reviewed timely and did not include adequate support for all reconciling items.

Once identified, the Company along with Deloitte and other consultants worked to identify and test each affected transaction and determined there were no instances of fraud or other irregularities. The Company has implemented numerous improvements which are in various stages of completion to mitigate the risks associated with these identified control weaknesses.

SUMMARY OF RECOMMENDATIONS

The Division recommends management continue to implement all identified internal control improvements to assure the noted material weaknesses and significant deficiencies are successfully mitigated. The effectiveness of these new internal controls should be tested and the controls should be incorporated into the annual MAR Controls Assessment process.

The Division recommends management implement procedures to assure the method used to calculate premium deficiency reserves follows the guidance promulgated in the NAIC Account Practices and Procedures Manual and Statement of Statutory Principles No. 54.

SIGNATURE PAGE

Acknowledgement is made of the cooperation and courtesies extended by the officers and employees of the Company during the examination.

The assistance rendered by Baker Tilly and Lewis & Ellis, Inc. who participated in the examination is hereby acknowledged.

John M. Curran, CFE
Supervising Examiner
Examiner-In-Charge
Commonwealth of Massachusetts
Division of Insurance